





*Price Waterhouse*

July 8, 1988

AUDITORS' REPORT

To the Directors of  
Izone International Ltd.:

We have examined the balance sheet of Izone International Ltd. as at February 28, 1988 and the statements of operations and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances, except as explained in the following paragraph.

Our examination revealed the following deficiencies in control, documentation and recordkeeping with respect to funds transferred for the benefit of Jensen Industries Inc., a 75% owned company incorporated in the State of Nevada (Note 3(b)):

- (a) Funds were transferred to individuals, received by them in cash without proper accounting for the use of the funds.
- (b) Documentation to support the use of the funds transferred was either inadequate or was not available.
- (c) Accounting records of Jensen Industries Inc. were either not adequately maintained or were not available.

As a consequence of the matters referred to in the preceding paragraph we are unable to arrive at a conclusion on the following matters:

- (a) We are unable to determine whether the funds transferred for the benefit of Jensen Industries Inc. were expended on behalf of that company.
- (b) We are unable to determine whether or not the investment made by the Company has any value.







July 8, 1988  
To the Directors  
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In our opinion, except for the effect of adjustments, if any, which we might have determined to be necessary had we been able to satisfy ourselves with respect to the accounts of Jensen Industries Inc., these financial statements present fairly the financial position of the Company as February 28, 1988 and the results of its operations and changes in financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

*Lin Waterhouse*

Chartered Accountants

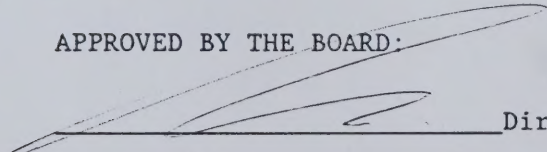


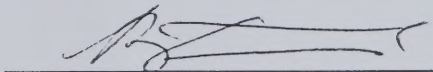


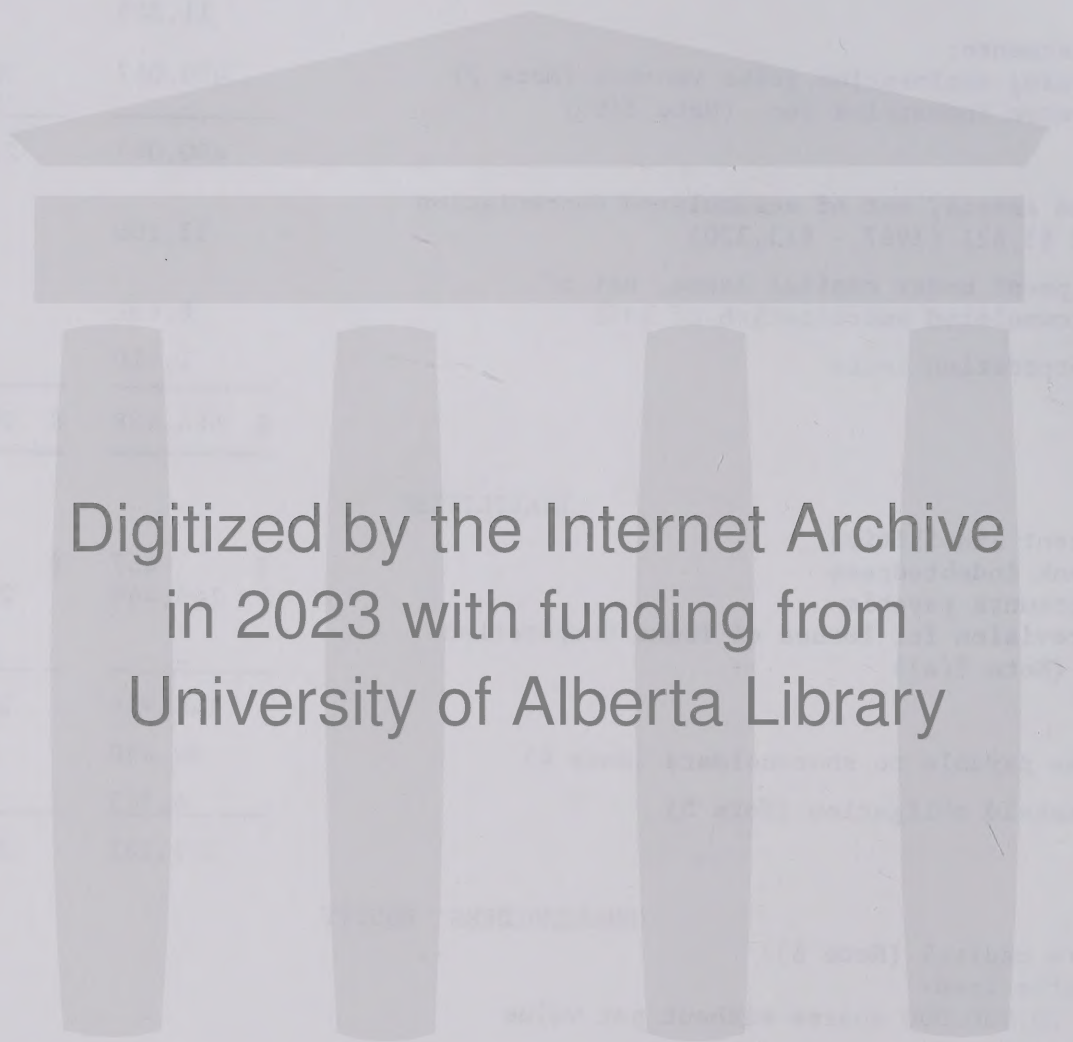
BALANCE SHEET

	February 28	
	1988	1987
ASSETS		
Current assets:		
Cash	\$ -	\$ 252
Prepaid expenses	9,233	-
Inventory	<u>1,992</u>	<u>-</u>
	11,225	252
Investments:		
Mining exploration joint venture (Note 2)	450,047	258,599
Jensen Industries Inc. (Note 3(b))	<u>-</u>	<u>20,796</u>
	450,047	279,395
Fixed assets, net of accumulated depreciation of \$3,621 (1987 - \$13,320)	13,105	6,380
Equipment under capital lease, net of accumulated amortization of \$961	8,651	-
Incorporation costs	<u>1,410</u>	<u>1,410</u>
	<u>\$ 484,438</u>	<u>\$ 287,437</u>
LIABILITIES		
Current liabilities:		
Bank indebtedness	\$ 457	\$ -
Accounts payable	146,449	212,458
Provision for losses of Izone Corporation (Note 3(a))	<u>-</u>	<u>68,600</u>
	146,906	281,058
Notes payable to shareholders (Note 4)	39,430	31,233
Leasehold obligation (Note 5)	<u>6,945</u>	<u>-</u>
	193,281	312,291
SHAREHOLDERS' EQUITY		
Share capital (Note 6):		
Authorized-		
20,000,000 shares without par value		
Issued-		
12,333,236 shares (1987 - 10,261,514)	5,828,146	5,019,949
Shares subscribed, not issued-		
825,000 shares (1987 - 60,000)	<u>185,000</u>	<u>16,800</u>
	6,013,146	5,036,749
Deficit	<u>5,721,989</u>	<u>5,061,603</u>
	291,157	(24,854)
Commitments (Notes 2 and 6(c))	<u>-</u>	<u>-</u>
	<u>\$ 484,438</u>	<u>\$ 287,437</u>

APPROVED BY THE BOARD:

 Director

 Director



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IZONE INTERNATIONAL LTD.

STATEMENT OF OPERATIONS AND DEFICIT

	<u>Year ended February 28</u>	
	<u>1988</u>	<u>1987</u>
Revenue:		
Rental income	\$ -	\$ 2,592
Expenses:		
Insurance	6,628	-
Depreciation	4,318	-
Travel and public relations	88,023	126,134
Audit and accounting	23,800	53,150
Management fees	47,749	48,165
Rent and office	42,205	33,853
Legal fees	14,446	33,398
Consulting and secretarial fees	13,746	20,500
Telephone and telex	25,469	18,417
Shareholder information	17,854	12,035
Other	<u>20,638</u>	<u>25,770</u>
	<u>304,876</u>	<u>371,422</u>
Loss from operations	304,876	368,830
Write-down of mineral properties and claims	-	6,100
Write-off of investment in Izone Corporation		
(Note 3(a))	98,953	-
Other	<u>(2,250)</u>	<u>(1,316)</u>
	<u>96,703</u>	<u>4,784</u>
Loss before extraordinary item	401,579	373,614
Extraordinary item (Notes 3(a) and (b))	<u>258,807</u>	<u>753,361</u>
Loss for year	660,386	1,126,975
Deficit, beginning of year	<u>5,061,603</u>	<u>3,934,628</u>
Deficit, end of year	<u>\$5,721,989</u>	<u>\$5,061,603</u>
Loss per share:		
Before extraordinary item	<u>\$ 0.03</u>	<u>\$ 0.04</u>
After extraordinary item	<u>\$ 0.06</u>	<u>\$ 0.12</u>



IZONE INTERNATIONAL LTD.

STATEMENT OF CHANGES IN FINANCIAL POSITION

	<u>Year ended February 28</u>	
	<u>1988</u>	<u>1987</u>
Cash provided by (used in) operating activities:		
Operations-		
Loss before extraordinary item	\$(401,579)	\$(373,614)
Items not affecting cash-		
Depreciation	4,318	-
Write-down of mineral properties and claims	-	6,100
Write-off of provision for losses of Izone Corporation	(68,600)	-
Other	<u>-</u>	<u>6,142</u>
	(465,861)	(361,372)
Changes in non-cash working capital-		
Prepaid expenses	(9,233)	-
Note receivable from shareholder	-	12,000
Inventory	(1,992)	-
Accounts payable	(66,009)	52,109
Provision for losses of Izone Corporation	<u>-</u>	<u>68,600</u>
	(77,234)	132,709
	<u>(543,095)</u>	<u>(228,663)</u>
Cash provided by financing activities:		
Issue of shares for-		
Cash	972,317	592,083
Debt	-	76,156
Mineral claims	4,080	7,920
Notes payable to shareholders	8,197	31,233
Leasehold obligation	<u>6,945</u>	<u>-</u>
	991,539	707,392
Cash provided by (used in) investment activities:		
Purchase of fixed assets	(15,982)	-
Purchase of fixed assets by capital lease	(9,612)	-
Purchase of investments (Note 3)	(238,011)	(435,485)
Proceeds on disposal of property and mineral claims	5,900	25,000
Investment in joint venture	(191,448)	(84,619)
Other	<u>-</u>	<u>1,371</u>
	(449,153)	(493,733)
Decrease in cash	(709)	(15,004)
Cash, beginning of year	<u>252</u>	<u>15,256</u>
(Bank indebtedness) cash, end of year	<u>\$ (457)</u>	<u>\$ 252</u>





IZONE INTERNATIONAL LTD.

NOTES TO FINANCIAL STATEMENTS  
FEBRUARY 28, 1988

1. Significant accounting policies:

(a) Mining exploration joint venture-

The investment in the mining exploration joint venture is accounted for at cost. The joint venture's activities are in the development stage and accordingly, the recovery of the cost of mineral claims and the realization of exploration expenditures thereon is dependent upon the success of the exploration program.

(b) Fixed assets and depreciation-

Fixed assets are recorded at cost; and depreciation is provided on a straight-line basis over their estimated useful lives.

(c) Leases-

Leases have been classified as either capital or operating. A lease which eventually transfers ownership of the leased asset by the end of the lease term is accounted for as if it were an acquisition of an asset and the incurrence of an obligation at the inception of the lease. All other leases are accounted for as operating leases wherein rental payments are charged to earnings as incurred. The asset recorded as a capital lease is amortized on a straight-line basis over its estimated useful life.

(d) Loss per share-

Loss per share is determined using the weighted average number of shares outstanding during the year.

2. Investment in mining exploration joint venture:

The Company has a joint venture agreement with two other companies which are related by way of common directors. The joint venture was formed to carry out exploration on mineral claims situated in the Kamloops Mining District of British Columbia (Adams Plateau). Under the terms of the joint venture agreement, the companies have agreed to pool a number of their contiguous mineral claims for a period of five years and each has a one-third interest in the joint venture subject to the retention of certain net smelter return overrides.





- (a) The Company contributed the following mineral claims to the joint venture (Adams Plateau)-
- (i) A 25% undivided interest in a mineral claim purchased for a \$70,000 work commitment.
  - (ii) A 33-1/3% interest in an option to acquire five mineral claims in respect of which, as of February 28, 1988, the Company has been required to pay \$3,333 and issue 48,000 shares. The Company is required to pay \$5,333 within the next year.
- (b) The joint venture entered into options to acquire the following claims-

- (i) Reg Mineral claims-

Five claims for \$48,000 and a \$400,000 work commitment. The Company's share of the outstanding cash payment and work commitments is as follows-

	<u>Cash payments</u>	<u>Work commitments</u>
1988/89	\$3,333	\$ 33,333
1989/90	4,334	41,667
1990/91	<u>-</u>	<u>41,667</u>
	<u>\$7,667</u>	<u>\$116,667</u>

- (ii) Ford Mineral claims-

Ten claims for a \$500,000 work commitment. The Company's share of outstanding work commitments is as follows-

1988	\$26,667
1989	<u>61,667</u>
	<u>\$88,334</u>

Under the terms of the joint venture agreement, the Company is required to contribute \$25,000 in fiscal 1989.

At February 28, 1988, \$1,249,402 (1987 - \$584,249) has been expended by the joint venture on exploration expenditures.



3. Extraordinary item:

(a) Write-off of investment in Izone Corporation-

In 1985 the Company entered into an agreement to provide interim financing to Izone Corporation as part of a Plan of Reorganization under the jurisdiction of the United State Bankruptcy Court of the Federal District Court, Southern District of California.

Under the conditions of the Plan of Reorganization, the Company paid U.S. \$225,000 to purchase 37.5% of the common stock of Izone Corporation. Effective March 1, 1986, the Company exercised an option to purchase an additional 12.5% of the common stock of Izone Corporation for U.S. \$75,000. Also the Company provided Izone Corporation with additional working capital increasing their common stock ownership to 81.7% (1987 - 69%).

Izone Corporation has been engaged since its inception in the business of the research, development, manufacture and sale of ozone generating devices for water purification purposes. It experienced financial difficulty when its initial product proved less reliable than had been anticipated. Sums originally intended for manufacturing and market development had to be expended for additional product development. Izone Corporation, with the infusion of additional capital and the completion of new product development, has continued to experience financial difficulty due to an inferior product which has proven unreliable and whose production has been discontinued.

Furthermore, Izone Corporation has no significant assets and has debentures outstanding of U.S. \$678,000 (1987 - U.S. \$684,000).

It is not expected that the Company will recover its investment and consequently, the Company-

- (i) had written-off its investment in Izone Corporation of \$753,361 in the prior year;
- (ii) has written-off all further investments in the subsidiary for fiscal 1988 of \$98,953; and
- (iii) has eliminated the \$68,600 provision for losses of Izone Corporation which had been set up in the prior year.





(b) Write-off of investment in Jensen Industries Inc.-

During the year, Jensen Industries Inc. (Jensen), which was to be a 75% owned company, was incorporated in the State of Nevada. Jensen had developed alternative ozone generation technology for the commercial market. As at February 28, 1988, the Company had made advances of \$258,807 to individuals associated with Jensen for the benefit of that company. In connection with these advances, the following deficiencies in control, documentation and recordkeeping occurred-

- (i) Funds transferred to these individuals were received by them in cash without proper accounting for the use of the funds.
- (ii) Documentation to support the use of the funds transferred was either not available or was inadequate.
- (iii) Accounting records of Jensen Industries Inc. were either not available or were not adequately maintained.

The Company has discontinued its association with Jensen and is attempting to settle its claims against the 25% shareholder.

Because it has not been possible to determine the benefit, if any, obtained by the Company from this investment, it has been written-off in the accounts of the Company.

4. Notes payable to shareholders:

Notes payable are unsecured, non-interest bearing and do not have a fixed repayment schedule.

5. Leasehold obligation:

The future minimum lease payments under the capital and operating leases of the Company, together with the obligations under capital leases after deduction of interest on the minimum lease payments are as follows-





<u>Fiscal year</u>	<u>Capital leases</u>	<u>Operating leases</u>
1989	\$ 2,431	\$ 8,534
1990	2,652	8,868
1991	2,652	8,868
1992	2,652	5,912
1993	<u>1,989</u>	<u>-</u>
Total minimum lease payments	12,376	\$32,182
Less: Amount representing interest	<u>4,566</u>	
	7,810	
Less: Current portion of principal payable	<u>865</u>	
Total leasehold obligation	<u>\$ 6,945</u>	

6. Share capital:

(a) Changes in share capital-

	<u>Issued</u>	
	<u>Number of shares</u>	<u>Amount</u>
Balance, February 28, 1987	10,261,514	\$5,019,949
Stock options exercised	920,500	326,375
Warrants exercised	487,000	211,100
Issued for cash	652,222	266,642
Issued for mineral claims	<u>12,000</u>	<u>4,080</u>
Balance, February 28, 1988	<u>12,333,236</u>	<u>\$5,828,146</u>

(b) Stock options-

Stock options have been granted to key employees and directors. The following options were outstanding at February 28, 1988-

<u>Number of shares</u>	<u>Option price</u>	<u>Expiry date</u>
44,000	\$0.50	May 22, 1988
68,500	\$0.35	December 5, 1988
125,000	\$0.45	April 22, 1989
50,000	\$0.70	May 15, 1989
<u>744,000</u>	<u>\$0.25</u>	<u>October 28, 1989</u>
<u>1,031,500</u>		



(c) Shares subscribed, not issued-

On July 6, 1988 the Company issued 675,000 shares as consideration for cash received before February 28, 1988.

7. Related party transactions:

During the year the Company had the following transactions with related parties-

- (a) Amounts totalling \$143,250 (1987 - \$76,700) were paid to a company controlled by a former director for exploration services.
- (b) Office and management services totalling \$22,385 (1987 - \$22,050) are payable to a company related by way of common directors.
- (c) Notes payable to shareholders at February 28, 1988 totalled \$39,430 (February 28, 1987 - \$24,166).

8. Remuneration of directors:

Management fees of \$34,000 (1987 - \$54,300) were paid or payable to directors of the Company in respect of the year ended February 28, 1988.

9. Subsequent events:

- (a) To July 8, 1988 common shares were issued for the following consideration-

	<u>Number of shares issued</u>	<u>Amount</u>
Stock options exercised	472,000	\$118,000
Warrants exercised	60,976	25,000
Issued for subscribed shares	675,000	-
Issued for mineral claims	12,500	5,000
Issued to settle a shareholder loan	<u>73,812</u>	<u>30,263</u>
Total shares issued subsequent to February 28, 1988	<u>1,294,288</u>	<u>\$178,263</u>

- (b) Subsequent to February 28, 1988, cash consideration of \$69,000 was received for 231,540 shares not yet issued.
- (c) On July 6, 1988, \$60,000 was received on the collection of a debenture previously written-off.



